2.1 INTRODUCTION

"Non-Performing Assets" (NPAs) held center stage in the financial set-up of banks and financial institutions. Though the importance on management of NPAs is insisted today, the term is not new to Indian banking. Even earlier, banker has used to handle sticky advances and make provisions against such advances. The system of asset classification, income recognition and provisioning norms were introduced by the RBI in 1992 is an explicit model of assessing the credit risk that a bank or financial institution has carried in its balance sheet. When implemented across the industry, it brings in consistency, transparency, objectivity, etc. in assessing the credit risk, besides receiving acceptance both in domestic and global markets. This is the main reason for the departure of the present day policies with those existing in the mid-80’s. The prudential norms, now introduced by the RBI, have not only brought in objectivity but also placed the actual risk position in a proper perspective so that the banks can take corrective measures from time to time to keep the credit portfolio strong and remunerative.

Banking regulatory authorities, policy makers and researchers alike are interested in research on NPAs. Since prudential norms have been implemented in co-operative banks only from 1999-2000, the study of NPAs in co-operative banks is a relatively new field of study. Hence, literature on empirical studies on the subject is limited. However, some studies have been undertaken by many committees and researchers. Hence, very few studies have been done on NPAs in co-operative banks. The important studies have been reviewed here:
2.2 INDIAN STUDIES

The Report of the Rural Banking Enquiry Committee (Thakurdas Committee) (1949) concluded that proper follow-up action was very essential. Banks have to maintain close contacts with the borrowers, keep track of the end-use of funds lent to the borrowers effective recovery of advances as per the repayment schedule.

The Report of the All India Rural Credit Review Committee (1969)\(^1\) stated that over-dues were a common problem both in developed and under-developed areas and found that the bulk of overdues were caused by big farmers.

The Report of the All India Rural Credit Review Committee (1972)\(^2\) stated that over-dues were rising since co-operative credit was short of standards of timeliness, adequacy and dependability.

RBI's Study Team on Over-dues (1974)\(^3\) estimated that more than three fourths of the over-dues were due to willful default. Faulty lending policies, failure to link credit with marketing lack of will on the part of management to take strong action against recalcitrant and willful defaulter, lack of financial discipline and apathetic of some of the State Governments towards creating an environment conducive and congenial to repayment of dues were the causes for over-dues.

\(^1\) Reserve Bank of India, The Report of the All India Rural Credit Review Committee (Bombay: Reserve Bank of India, 1969).
\(^2\) Reserve Bank of India, The Report of the All India Rural Credit Review Committee (Bombay: Reserve Bank of India, 1972)385.
\(^3\) Reserve Bank of India, The Report of the Study Team on Overdues in Co-operative Credit Institutions(Bombay: Reserve Bank of India,1974) 20,59,63.
Dadhich (1977)\textsuperscript{4} found that there was strong association between repayment and caste, crops grown, fertilizer utilization, occupational pattern and irrigation. The main causes found for willful default were re-lending practices, which enabled to make profit out of the interest margins.

The RBI conducted a special study in 1978\textsuperscript{5}, which estimated that the accumulation of over-dues was largely due to willful default and partly due to irregular lending, lack of supervision, indifferent recovery efforts, inaction against defaulters, unnecessary interference of State Governments in the recovery of the credit, domination by the vested interest of politicians and the elite.

The Report of the Study Group framed guidelines for follow-up of bank credit (Tandon Committee) (1979)\textsuperscript{6} framed guidelines for monitoring and follow-up of bank credit. It suggested norms for holding raw materials, stock in process, finished goods, receivables and bills purchased and discounted.

The Report of the Working Group to Review the System of Cash Credit (Chore Committee) (1979)\textsuperscript{7} stressed the need to strengthen the monitoring system and suggested simplification of the information system proposed by the Tandon Committee.

\textsuperscript{4} C. Dadhich, Overdues in Farm Co-operative Credit: A Study of Rajasthan (Bombay: popular prakasan, 1977).
\textsuperscript{5} Reserve Bank of India, Special Study (Bombay: Reserve Bank of India, 1978).
\textsuperscript{6} Reserve Bank of India, Tandon Committee, Report of the study Group to Frame Guidelines for Follow-up of Bank Credit (Bombay: Reserve Bank of India, 1979).
\textsuperscript{7} Reserve Bank of India, Chore Committee, Report of the Working Group to review the System of Cash Credit (Bombay: Reserve Bank of India, 1979).
The CRAFICARD (1980)\(^8\) endorsed the findings of the Study Team on Over-dues and found that in many cases the default was willful and that too it was by the big farmers.

The Report of the Committee on Mechanization in Banking Industry (Rangarajan Committee) (1983)\(^9\) emphasized that mechanization was the first step to recovery management.

Kalyankar (1983)\(^10\) study on crop loan over-dues of co-operative finance revealed that 60 per cent of the over-dues were from 27 per cent of the big farmers who had the capacity to repay but had neither the will nor the intention to do so.

Reddy and Reddy's M.N.R. (1985)\(^11\) showed that there was a positive relationship between asset status and debt accumulation and between the level of borrowing and willful default in Nellore District, Andhra Pradesh.

The Report of the Committee of Top Executives (1987)\(^12\) stressed that close efforts on the part of banks to monitor end-use of funds would result in increased productivity of the borrowers.

Reddy (1988)\(^13\) found that there was association between socio-economic factors, adequate/timely credit and borrowers' repayments in Andhra Pradesh.

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\(^9\) Reserve Bank of India, Rangarajan Committee, Report of the Committee on Mechanisation in Banking Industry (Bombay: Reserve Bank of India, 1983).


\(^12\) Reserve Bank of India, Report of Committee of Top Executives (Bombay: Reserve bank of India.1987).
The Report of the Agricultural Credit Review Committee (1989)\textsuperscript{14} stated that there was significant relationship between agro-climatic conditions, literary rate, major crops grown and over-dues. The Committee deduced that the general climate in rural areas was becoming increasingly hostile to recoveries due to increasing politicization of agricultural credit. The Committee viewed that inadequate loan amounts compelling the borrowers to resort to borrowings from money lenders and other informal sources of credit and fixation of due dates unrelated to the harvesting and marketing seasons and absence of linkages of credit with marketing were the main causes for over-dues.

According to the Report of the Agriculture Credit Review Committee (1989)\textsuperscript{15} prevention of recycling of funds, impaired refinance eligibility and productivity of co-operative banks. Nearly 26 per cent of the resources deployed by the credit agencies for the agriculture sector were locked up in over-dues and were not available for recycling. At the institutional level, the clogging of over-dues had severely impaired the eligibility of the credit agencies, for refinance from NABARD. As a defaulter, the borrower is cut off from any access to credit from institutions. This affects his productive enterprise.

\textsuperscript{13}C.R.Reddy, Co-operative Long-terms Finance — A Regional Study (Delhi: Publications,1987) 80-82.
\textsuperscript{15}Reserve Bank of India< The Report of the Agricultural Credit Review Committee (Bombay: Reserve Bank of India, 1989).
Naik, et al., (1991)\(^{16}\) reviewed the role of credit co-operatives in rural development within Andhra Pradesh and concluded that co-operatives are the most suitable institution for loan disbursement in the area.

Vaikunthe (1991)\(^{17}\) evaluated the performance of the Dharwad DCCB Karnataka, and found that credit utilization in non-irrigated areas was not efficient, but repayment was more regular.

Reddy (1993)\(^{18}\) study on overdues management in Andhra Pradesh portrayed that unsound lending policy, defective appraisal, misuse and diversion, unsatisfactory marketing arrangements, lack of effective follow up, effect of natural calamities, political considerations, write-off /waiver of interest, Government policy, sometimes, hindered the recovery even from the borrowers who raise good crop production.

Goyal, et al., (1993)\(^{19}\) conducted a study in Hisal DCCB, Haryana. The defaulted borrowers utilized a relatively larger proportion of their total earnings for consumption purposes, thereby leaving less for investment in production processes.

Lal and Singh (1993)\(^{20}\) studied the unutilization of co-operative credit in agriculture in Kukathala of Achnera block of Area district and found that marginal and small farmers i.e., remained unutilized a maximum percentage of loans to weaker section.

\(^{17}\) Reserve Bank of India, The Report of the Agricultural Credit Review Committee(Bombay:Reserve Bank of India, 1989).
Kunden, H.N (1994)\textsuperscript{21} stated that, “Many co-operative banks become sick banks because of non-following of business and co-operative and economic principals in their day to day working. According to the new norms of NPA the profit earning capacity of these banks have affected adversity and many banks have come into the financial crisis. To improve their financial position, they have to concentrate their attention on the proper security of loan proposals before sanctioning the loan and on the end. As also have they concentrated on the recovery of overdue by creating a separate loan recovery committee” To affect recovery, one has to try various methods including persuasive and coercive improper lending policy may lead to overdue and faulty documentation may add to the problem in process. So far as responsibility of recovery is concerned there is hardly anything specified anywhere though it is said that ‘co-operator’ are morally responsible. This moral responsibility is to be spelt out in specific terms both in the act and the rules and bye laws of the society. Management efficiency of concerned co-operative also plays an important role in effecting recovery. The management efficiency is composed of many factors so far as recovery of credit is concerned it relates to proper lending policies and advancing of loans effective and timely supervision over the utilization of loan and prompt action for recoveries by adopting persuasive and coercive method whenever necessary this is possible by proper planning, delegation of powers and functions to executives and observing a discipline to non- interference in the recovery process.

\textsuperscript{21} Kunden H. N. Director (1994) (Janata Sahakari Bank Pune), Article “Nagari bank A need of Research Development” daily Lokastta 1\textsuperscript{st} May 1994
Kusumakara Hebbar (1994)\textsuperscript{22} studied of 15 PACS in Mangalore, found that the recovery problem was more in the case of short-term and medium-term loans.

Sourindra Bhattacharjee (1996)\textsuperscript{23} concluded that improving the total gross margin was the most important route for increasing the profitability of the co-operatives.

Gopalakrishnan (1996)\textsuperscript{24} suggested that the bad effect of Debt Relief Schemes should be important on the minds of borrowers.

According to Jain et al., (1996)\textsuperscript{25} the loan waiver schemes had succeeded in redemption of old dept but recovery of fresh loans was a major problem faced by the co-operative farm credit sector in Madhya Pradesh.

Shollapur (1996)\textsuperscript{26} studied that the Belgaum DCCB in Karnataka state and the study showed that more than fifty per cent of the PACBs remained uninspected. Inadequacy was phenomenal even in passing the credit collection to the CCB.

Varma and Reddy (1997)\textsuperscript{27} showed that the agricultural credit through DCCBs and PACS had grown in terms of coverage and growth in Andhra Pradesh after reorganization.

Rangarajan, C (1997)\textsuperscript{28} pointed out that “Another weak link in urban co-operative sector is lack of professionalism. In a competitive financial milieu where the customers look for innovative products and efficient service, the UCBs cannot insulate themselves from the rising demands of their clientele”. Urban co-operative sector is facing with a serious problem of weak and sick banks. As per Report on Trade and Progress of banking in India (RBI) 1990–2000, the number of weak UCBs showed rise and stood at 261 as on 31/3/2000 as against 250 as on 31/3/1999. The Madhav Rao committee identified the problem being faced by the UCBs (1) duel control (2) increasing incidence of weakness (3) low level of professionalism, absence of compliance with prudential norms and the absence of timely identification of sickness have been the majority of contributory factor behind present weaknesses of certain UCBs to get warning signals.

The Madhav Rao Committee recommended certain criteria of CRAR, NPA and history of losses for identification of weak/sick bank, post identification these banks may be placed under moratorium under the Banking Regulation Act and reconstruction/rehabilitation may be carried out.

Balishter et al.,(1998)\textsuperscript{29} conducted a that the study in Agra District, found out that willful default was mainly confined to medium and large farmers to the extent of over 90 per cent.

Tarapore, S(1998)\(^{30}\) suggested that “The concept of narrow banking has raised considerable debate in the Indian financial sector. Central to the concept of narrowing banking is that a bank which is weak should taper down its incremental credit deposit ratio. The essence of this line of reasoning is that banks with very weak credit management structure would merely invite more NPAs. Now it there if a balance sheet cleanup and a bank continues its lending spree, in all probability it will pile up NPAs. The arguments against narrow banking are that the profitability would be affected, that Government securities would reduce the income of banks” The article as above discusses the narrow banking concept it size it may weaken the bank, which weakens the credit deposits - ratio, weakens credit management and generates more NPAs. However, it has not been successfully used by Indian banks. The narrow banking concept has been use in most of international banks. If we use narrow banking concept in the bank to expand credit deposit ratio, means provide more loan to the borrower and increase their credit portfolio, that way NPAs will be reduced. The proportion of deposit would fall and the clean balance sheet would appear.

Murty and Durga (1998)\(^ {31}\) studied, equity and efficiency of co-operative credit and found that efficiency and recovery were related. Efficiency also suffered because the recovery of loans was very poor.


Prem Sharma (1998) concluded that in the aftermath of the Financial Sector Reforms, the co-operative banks had to meet the challenges of the financial sector reforms by competing with Public Sector Banks and Private Sector Banks in mobilization of deposits, savings and advancing of loans to tone up their functional effectiveness and attain capital adequacy norms.

Lakshmi, et al., (1998) conducted a study in Kuttanad region in Alappuzha district, the rice bowl of Kerala, identified that marketed surplus, time of sowing and credit gap were the major characteristics that discriminated the borrowers of crop loan from defaulters.

Rabi Narayan Mishra (1998) found that the attitude towards repayment in Orissa disclosed that the percentage of defaulters in literate category was higher than that of illiterates and was the highest among the general caste borrower.

According to the comparative study of NPAs by Sathyanarayana (1988), who studied NPA in Venezuela, Mexico, Thailand, Brazil, Japan, Taiwan, Colombia, Chile, Korea, Argentina, Indonesia, Malaysia, Hongkong, USA, and Singapore pointed out that except in Latin America the NPAs levels were in single digit (6 per cent to 7 per cent). India compared unfavourably in the international arena, as India had the highest proportion of NPAs (14.45 per cent) among the 16 countries in 1994-1995.

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Sudhakar Patra (1998)\textsuperscript{36} revealed that the Boudh CCB in Orissa was not successful in making profit due to non-repayment of loans in time.

The Working Committee (1999)\textsuperscript{37} concluded that the NPAs considered for write-off, compromise, one time settlement should be identified for recovery of NPAs. It recommended compromise model for the recovery of NPAs as the most effective mechanism. However both write-off and compromise are steps to be taken with caution and due monitoring.

RBI study (1999)\textsuperscript{38} stated that banks were required to closely monitor the operations of the borrowing units. In respect of accounts where the classification of asset worsens, banks were required to take prompt steps to recover the dues and staff accountability was required to be examined. Special emphasis was given on monitoring of large NPAs accounts, also on reduction of NPAs, through upgradation, recovery, and compromise settlements.

Raravikar Yashwan (1999)\textsuperscript{39} found that the Indian banks have made a quantitative progress in amount of deposits and loans and advances but they have not successfully complied the qualitative norms such as credit supply to the priority sector, capital adequacy and profitability etc. The annual overall performance of the bank is decided on these qualitative parameter” One more article can be referred to have is “Bad assets are

\textsuperscript{37} Reserve Bank of India, The Report of working Committee (Bombay: Reserve Bank of India,1999).
\textsuperscript{38} Reserve Bank of India, "some Aspects and Issues relating to NPAs in Commercial Banks," Reserve Bank of India Bulletin 50.3(July 1999): 913-936.
increasing not only in absolute terms but in percentage term too, even if the overall size of the portfolio is increasing if NPAs were constant their percentage as a part of the total advance would have remained constant but is not the case so the quantum of bad loan is rising higher than the overall increase in loan” Bank and financial institution are facing the problem of NPAs. The question of Rs 1,10,000 crores of NPAs amount, highly effect on banks profit. High level of NPAs reflects on the financial strength of bank in globalization are required to conform to stringent international standards. The government is forced to recapitulate weak bank from time to time. Three banks namely UCO Bank, United Bank of India, Indian Bank has made provision of Rs 1,300 crore, proposed for recapitalization. The major part of NPAs amount is recovered by, and along with legal route against the defaulting borrowers. The BIFR and DRTs set up by the Govt. but not proved to be of much help. As on 30th September 2001 the DRTs had disposed of 18703 cases involving Rs 14,026 Crores. Recovery made was Rs 3,527 crores. During 2002-03 was Rs 3252 crores, against Rs. 2153 crores during the previous year. The first time the cases disposed by DRT have exceeded number of fresh cases registered with them. Govt. also set up the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002. The trade and industry has been also affected on account of rising NPAs in banks because, on the one hand there is a problem of increasing financial position and on the other hand is good borrowers are often required to pay higher costs for the funds. There must be borrowers to compensate the losses caused to banks account of high level of NPAs.
Raravikar Yashwant (1999)\textsuperscript{40} concluded that the “Bad and Doubtful Debts of the banks must be recovered” “thought the Indian banks have made a quantitative progress in respect of number of branches, amount of deposits, loans and advance, but they cannot successful such as credit supply to priority sector capital adequacy and profitability etc. the annual overall performance these qualitative parameter. The debt recovery of the nationalized banks is not as good as private commercial banks. Debt recover of the bank should be given priority.” No doubt, debt recovery is important aspect of every bank and low recovery campers to the NPAs amount. According to the trends and progress of banking in India since 1998-99 as report published by RBI in the year for sunk loan and advances of the bank in the country is a very high amount of Rs. 58,554 crores. At the end of March 2001 NPAs figures change because Government gave priority to debt recovery. Recovery of the bank must be strong because of existence and progress of the bank depend upon the proportion of recovery of given loans and advances.

Rangarajan, C(1999)\textsuperscript{41} concluded that the “As regards NPAs, so long as these sterile assets remain on the books, it will be difficult for banks to raise their profitability to the desired level. The drawback of a centralized nationwide Asset Reconstruction Fund (ARF) in the Indian environment is the lack of geographic reach for a new institution to a large country, such as India as well as concerns that releasing commercial banks from their recovery obligations would weaken them. This could also encourage such accounts


\textsuperscript{41} Rangarajan C (1999) “ Inaugural addresses of the national seminars on Trade & Financial Sector Reforms” NIMB, Pune 18 Oct 1993
themselves going sick. In addition, there is the issue of how to finance the capital shortfall, created by cutting down an even greater part of the assets portfolio than is required by the minimum provision requirements. No single solution can resolve the problem of NPAs. We have opted to go in for a decentralized approach, under which, work out units are created in each bank. Individual banks will have to take a range of initiatives taking into account the circumstances specific to them.” The imperative methods for banks in tackling the problem is to improve recoveries, and to improve credit appraisal and administration specially monitoring to cover existing as well as fresh borrowers account. The problem of NPAs is not only in India but also it prevails in many Asian countries. In China, NPAs were around 45% of GDP while the equivalent figure for Japan was around 28% the level of NPAs have been increased in Malaysia was around 42%. On an aggregate level, Asia’s NPAs have been increased. The recovery processing for resolution of NPAs Mergers Act, deferred loss write off provisions have been instituted to provide breathing space for lenders to absorb NPAs write-offs.

Phadnis (1999)\(^\text{42}\) justified the Narasimham Committee's observation that asset quality was very poor in direct lending, since around 48 per cent of NPAs were in priority sector advances group.

Lopoyetum (2000)\(^\text{43}\) stated that there was a direct and positive relationship between period of default and cost of default by the defaulters.

Namasivayam and Ranachandriaiah (2000)\textsuperscript{44} concluded that the productive loan as a proportion of total loan was higher for marginal farmers among non-defaulter and control groups who were utilizing loans predominantly for digging and deepening wells. The crop loan tended to be more often misused than term loans. This may be partly due to untimely issue of loans.

Ravichandran (2000)\textsuperscript{45} concluded that the political exploitation became the major cause for delinquency, compared to other causes for over-dues, viz., crop failures, increasing family expenditure, and social obligations. A significant portion of defaulters were of the opinion that in Tamil Nadu Government waiving schemes was the major cause for this delinquency.

Reeta Mathur (2001)\textsuperscript{46} stated that “The Narasimhan Committee has reiterated its suggestion for ARCs and has made a strong case against further bank recapitalization. While it is true that recapitalization is costly and in the long run unsustainable, can we see the ARCs as an effective panacea to the bad debt problem of bank? What the Narasimhan Committee has suggested is that the hard –core NPAs of most banks be carved –out and transferred to an ARC which could be funded and manned by banks themselves so as to maintain “institutional memory” on NPAs to effect recoveries. Suggestions for securitization of such loans and establishment of ARCs by banks and DFIs have also been made. Appropriate changes in the legal system and provision of tax

\textsuperscript{45} K.Ravichandran, Crop Loan System and Overdues, (Rohtak: Spell Bound Publications, 2000).  
incentives have also been recommended. A “carve-out” of the bad debts of banks is far more complex than is understood. “carve-out” of addressing the “flow” aspect, and backlog of NPAs represents the “stock” aspect, flow losses arise from making fresh loans, which may turn bad. The “flow” problem is best addressed by tacking the underlying causes for loans turning bad.” It concluded to import of resolution of NPAs. NPA constituted a real economic cost to the nation is that they reflect the application of scarce capital and credit funds to unproductive uses. The moneys locked up in NPAs cannot be used for productive aspect and to the extent that banks seek to make provisions or write off, it is a charge on their profits. Banks have to charge their productive and diligent customer a higher rate of interest. It is the customer who uses the loan facility and late represents by NPAs. They also raise the transaction costs in the system thus denying the diligent credit customers the benefit of lower rate which would help them to be more efficient and competitive. NPAs are not problem for banks only but also it is bad for the economy. The problem of NPAs in the system has to tackle ‘Stock’ (accumulation of NPAs) and ‘Flow’ (accretion) problem. NPAs management approach needs to reduce or upgrade at different stage of credit process. Several steps like OTS, Lok Adalats, DRTs, and new SRFAESI are strengthening of credit appraisal and monitoring system, establishment of CIBIL etc. regulators to tackle the ‘flow’ problem towards resolution to the ‘stock’ problem of NPAs. The RBI has put bindings on banks to declare dividends without its permission. The RBI has restricted dividend declarations for banks with net NPAs of above 3 percent. A large number of public sector banks have net non-performing assets ranging between 10 to 20 per cent of net advance. The Narasimham
Committee has underlined the need to reduce the average level of net NPAs to all the banks to 3 percent. To reduce the backlog of NPAs and improving the management efficiency and liberalization of interest rates, development of money, capital and debt market and giving operational flexibility to banks. NPAs are also known as ‘documentary dacoits’ some big industries generate large huge amounts of NPAs. The following companies which include dues to Financial Institutions such as IDBI, ICICI, IFCI etc., Merdia Group of Chemicals Rs.1450 crores, Lloyds Group Rs.1012 crores, Patheja Group of Industries, Rs.547 crores, Matfatlal Group Rs.598 crores, J K Group Rs.698 crores etc. Some of them are willful defaulters. The dilatory legal process in the country willy-nilly supports and even encourages the willful defaulters to hoodwink the bankers.

Talwar S.P. (2001)\textsuperscript{47} study revealed that after 1991 reform in banking business globalization, liberalization, privatization the management strategy for three factor consideration. 1) To effective credit management and recovery of NPAs, 2) to used risk management system and 3) to improvising internal control mechanism. “Based on Indian banking sectors reforms, recommended Narshinhan Committee after 1992”, India is a developing country as the government has viewed the primary entrepreneur in the economy. The financial system was restricted to the function of channel sing resources from the saver to the allocated uses. Indian business based on “social control” after nationalization of private commercial bank in 1969 and 1980. But ‘Classic Banking’ into

‘Mass Banking’ started, when Govt. raising resources from banking business by fiat and by raising statutory liquidity requirement, deposit mobilized, direct credit programmers and maintaining low interest rate. The bank restructuring become more and more productive, and to certain core issues like control over the cost, technology improvement etc.

Das’s (2002) study the Arunachal Pradesh SCB unveiled the improper utilization of loan and the insignificant repayment behaviour has stood on the way of the development procedure of rural sector. Although many literatures are available on co-operative credit recovery, default etc., very few studies have been made with reference NPAs in Co-operative banks and the effect of NPAs. Particularly no such study has been conducted in the present study area. Hence, this study seal to probe into the position of NPAs and the factors leading to default in the study area.

Krishnamurthy, K.V (2002) evaluated that “The major culprits behind high NPAs levels are willful default mismanagement and lack of planning. Public money obtained from bank has systematically siphoned away from our industries. The problem of NPAs has degenerated to such an extent where in an effort to assign the blame, even trade unions have ventured in recent time to publish lists of defaulters because of whom, they consider that some banks are in dire financial straits these lists are over and above the official listed published by RBI of bank-wise defaulters one crore and above.

“Finance Minister Jaswant singh’s statements in the Rajya Sabha that Non Performing

Assets of Rs.83,000 crore is loot and not debt”. The solution to the problem of NPAs should strengthen the credit portfolio of banks over a period by removing the present deficiencies observed standard credit appraisal, monitoring and follow-up and improving the overall lending polices of bank as well as Governments Policies. The weak capital position of Indian banking system is largely a reflection of growing assets – quality problems stemming from weak underwriting and credit management systems and vulnerabilities of the Indian banking sector to the impact of globalization on the country’s key industrial sectors. The assets quality position has also suffered from regulations with respect to lending to priority sectors. The problem of NPAs in Indian banking system is very high because our credit policies are weak which has made our so the banking system weak and unsound. The ripple effect of NPAs as in the case of cancer is gradually felt in all parts of the economy i.e. saving, investment, production, employment, and services which affected capital, economic growth.

Rao (2002)\textsuperscript{50} suggested that the default of bank loans as criminal offence and punishment be awarded along with financial recovery, authorizing seizure agencies and giving them a legal status to recover loans.

According to Samal (2002)\textsuperscript{51} NPAs overhang was due to defects in legal processes like prolonged / delayed legal system, absence of proper legal framework for non-payment of bank's dues.\textsuperscript{52}

Vivekanandan .K .K (2002)\textsuperscript{53} stated that “The present structure of banks in India has been the result of historical evolution and barring the creation of regional rural banks after 1975, the structure remain broadly what it was at the time of nationalization of banks. The issue of restructuring of the public sector banks has been studied at various times and by at least three committees in the past and through recommendations were made in the direction of restructuring of the system, an action was taken towards implementing these proposals in the light of perceived administrative.” It discusses the recommendation issued for the committee to take action on large banks specifically the rural areas and whose business predominantly based on finance of agriculture and allied activities. After 1992 freedom of entry was given to banking business because RBI established new banking system and requirement of prudential norms. Result is liberalization and globalization, system is in much better and shape and operates within set of internationally recognized norms of income recognition assets classification, provisioning against doubtful /bad debts and capital adequacy norms. The committee believed that balance sheet of banks to be made with full transparent full disclosure. Our time taken legal system has caused the blocking of the recovery of huge funds willful defaulter, consequently formation of assets reconstruction funds to take over bad debts of banks, so this financial year SBI, ICICI Bank, HDFC, etc NPAs amount transferred to ARC, NPAs ratio is declined zero per cent to three per cent. Today we see that the private sector banks are a challenge to foreign banks, a challenge not in providing but credit in

\textsuperscript{52} Reserve Bank of India, Purushottamdas Thakurdas Committee, Report of the Rural Banking Enquiry Committee (Bombay: Reserve Bank of India, 1949).

generating NPAs. There is blocking of 25.3% NPAs in Foreign banks, among them a portion of NPAs blowing is shared.

Bhattacharya, K M (2002)\textsuperscript{54} stated that ‘the problem of NPAs is multidimensional and unless the same is checked and the NPAs level is brought down to the international standards of 2\% to 3 \% of total loan assets it is bound to weaken the banking system. A major stumbling block for the banks to reduce their NPAs has been the prevailing legal system in the country”.

Partha Ray and Indranil Sengupta (2003)\textsuperscript{55} concluded that “Indian banking system was based on measures for improving the health of banking system and related regulatory and supervisory Initiatives, when the reform process started in the Indian economy after 1992. The recommendation of the committee of financial system and issues relating to the financial sector including reduction of directed credit allocation, liberalization of interest rate and ensuring increased competition”

Indranil Sengupta (2003)\textsuperscript{56} concluded that the “Non – performing loans are challenge to the banking system” a reduction in NPAs would be recovery problem for every banking and financial institution. Govt. has taken to reduce a portion of NPAs for addressed Lok Adalats, Settlements advisory committees, and SRFAESI 2002. The RBI

\textsuperscript{54}Dr K M Bhattacharya (2002)” Dealing with the NPAs Menace” The Economic Time 27 Dec 2002 P6
\textsuperscript{56} Indranil Senguta and Partha Ray (2003)“System Restructuring Of Banking the Indian experience” Bank Quest, IIB&F VOL 74 /4 Oct – Nov2003 P.P11 to 12
has now advised banks to monitor ‘special mention accounts’ accounts, which the bank feels could turn into non performing assets”.

Ranjana Kumar (2003)\(^57\) stated that the “Non-Performing Assets (NPAs) are a severe drain on the profitability of the banks. On the one hand, no income on such account can be recognized and on the other hand, certain amount provision has to be made from the profit, depending on the asset classification and availability of security.”

The problem of NPAs has two faces, i.e. the recovery of amount and the other provision transferred to the profit, it is improved credit assessment and credit processes. The recovery of NPAs goes to its staff members; banks should develop proper risk forecasting techniques, which should enable them to check generation of fresh NPAs. The Indian Legal System, fail to protect them. It protects the borrowers and not the lenders. 75 percent borrowers are standard but 25 percent are substandard. The creditors have practically no rights, as a result no money was disbursed to the borrowers. It is often said, “In India, there are sick companies and closed factories, but not sick promoters”

Venkataram. R (2003)\(^58\) stated that the “RBI guideline on the same require a very careful reading to repayment of principal as well as payment of interest by the borrower. RBI did not guide for making provision for the principal repayments at the discount value”. It helps the industries to lighten over liquidity problem due to recession, by restructuring of their dues on the one hand and the banks minimizing the provision


requirements in respect of such accounts. Only Standard and Substandard assets, where repayment of dues is reasonable assured are permitted to be restructured. Also provision for an equal amount should also be made, so income should be fully provided. An improvement in this sphere by upgrading the skill of practical bankers dealing with the borrowers at the grass root level will go a long way in reducing the level of existing NPAs and reduce the incidence of fresh NPAs in the future.

Rajesh Sood (2003)\textsuperscript{59} stated that the “Risk based supervision look, at how well a bank identifies, measures, control, and monitors risk. Identify systemic risks, the system provides an opportunity to the regulator to monitor banks, performance based on CAMLS/ CALCs approach”. CAMLS means Capital Adequacy, Asset Quality, Management, Earning, Liquidity, System and Controls – applicable to all banks and CALCs stands for Capital Adequacy, Liquidity, Compliance and Systems – applicable to Indian operation of banks incorporated outside India. The RBI now makes implementation of Risk Based Supervision (RBS) for all commercial banks to set up to match risk management system, which is based on new Basel Accord. For the bank disclose in their balance sheet, about risk management policies, procedure and practices, which affect not only the reduced NPAs but also promotes major processes on profit, deposits, advances, inspection and action etc. The RBI introduced the RBS approach that bank should develop its responsibility.

\textsuperscript{59} Rajesh Sood (2003) “Risk Based on Supervision:- A new tool with supervisor for managing risk in bank” IBA Bulletin Sep 03 P.P 5 to 10
Rakesh Malhotra (2003)\(^6\) concluded that “the government has been taking elaborate extensive initiatives (both policy and administrative) to augment the outreach of formal channel to rural masses. Government of India had been seized of the small and marginal farmers, rural artisans, agricultural laborers deprived of the crucial input of timely and adequate credit from the institutional sources. Effort was made to convert all financial parameters into ratio so that the size of the RRB did not unduly tilt the balance of comparison to one side.” This article throws light and the wide performance of RRBs, which has 198 banks in whole country having 14300 branches which have been operated by 70200 employees. RRBs established under Indian Act of Parliament is called Regional Rural Bank Act 1976, and in consultation with NABARD. RRBs financial parameters developed on human resource. Because, RRBs have been sponsored some schemes at districts level only. Its performance is in the ratio based on productivity of per employee, interest expenditure, credit deployment; here credit deployment is based on NPAs. The money locked up in NPAs is not available for productive use and in cases of financial constraints of the bank. The high levels of NPAs have been a major profit block. By the way, recovery is important part of RRBs bank. Best bank productivity depends upon best employees.

Misra, T.P (2003)\(^6\) stated that “the profitability of the financial institution largely depend upon the level of income generated though optimum use of assets after paying the


cost of funds for acquiring them and other administrative costs. Which not only have cost of funds involved but also requires to be provided as per prudential norms, they also pointed concept on NPAs, objective parameter, and mentioned classification of NPAs and objective of credit Management and developed for handling credit portfolio in an era of increased global competition and liberation.” This article visualizes new approach of reliability of income to develop credit management profit and risk approach, for all repayment received from NPAs accounts. Cost of funds increasing for up gradation of non-performing assets with recovery which supported by climate, legal system, approach to the lenders interest, also account should be rescheduled / restructured before such account slips to NPAs. Banks have to perform well to achieve the targets for NPAs reduction as per international standard. Bank by improving the overall quality of loan assets, naturally cost of fund would increase. The problem of NPAs is not a matter of concern for Banks and FIs, as credit economic growth of the country and any bottleneck in the smooth flow of credit is bound to create adverse repercussion in the economy “It is the responsibility of banking institutions to maintain the quality of their credit portfolio. Direct credit, per se does not lead to non-performing assets; banks have a choice of borrowers. There is evidence to show that the proportion of non-performing assets among banks can be effectively used in monitoring accounts and improving the overall quality to loans assets.”
Ajaya Kumar Monhaty’s (2004)\textsuperscript{62} found that the “Compliance with accounting standards” which mentions, “International Accounting Standards require that all financial assets and liabilities to be recognized on balance sheet under IAS 39, Management have absolute discretion as impaired assets recognition of NPAs. If impairment calculation and carrying amount of the financial assets is compared with the discounted present value of the currently estimated amount and timing of payment, original effective interest rate of financial instrument is used in impairment calculation. For discounting compares the carrying amount of the financial assets under US, GAAP. Under IAS as well as US, GAAP there is on specific prescription for interest accrual on NPAs; interest is suspended up on Non Performing Advance.”

The RBI has issued several guidelines for the banks. IAS 39 gives, discretion assets classification and assume full repayment of principal or interest. Advances were classified as standard, sub-standard, doubtful and loss assets are based on international norms. In India, since 1995, loan with interest and or installment of principal over-due more than 180 days (90 days since 2004) past due classification rule for NPAs made on RBI. The provision has requirements of minimum of 0.25 percent introduced for standard assets and sub-standard10 percent. Under IAS there is no specific precipitation for general provisioning non-performing assets. Accounting standard is preparation of financial statement of different enterprises with a view to provide meaningful information to the users from such data. The recommendation by the IASC that, once balance sheets

are cleaned up though such process take due care and pay attention, to loan proposals and supervision and make adequate provision for assets of doubtful realisable value on an ongoing basis.

Kishori J Udeshi (2004)\(^{63}\) study revealed that “World now turned to some of the issues on which the RBI has taken action in the recent period. As part of a move towards greater deregulation, banks fulfilling certain minimum criteria regarding Capital to Risk Weighted Assets Ratio and Non-Performing Assets have been given the discretion to pay dividend without the prior approval of the RBI. In view of the ongoing shift towards financing borrowers based on estimated cash flow rather than on collateral and in recognizing of the availability of financial assistance through credit substituted viz., commercial paper, bounds and debentures, these restriction on unsecured exposures was withdrawn and banks boards are allowed to form their own policies on unsecured exposures.”

Rajendra Kakker (2004)\(^{64}\) found that “the absence of direct funding support by the government, ARC would be self-help mechanism of the banking system. The banks/ FIs /ARC to plan up the NPAs. The bank/FIs have to be proactive in making realistic provision based an assessment of realization from NPAs towards their dues”. The points raised in articles above, it is pointed out that we depend upon NPAs/NPL resolution process of ARCs in India. ARCs are Government sponsored or government has direct

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participation in it. The ARCs have been fully success deployed to implement a comparatives NPAs management strategy in the aftermath of systematic banking crisis notable in East Asian Countries, Korea and Taiwan etc. The recovery of NPAs, though an Assets Reconstruction Fund (ARF), enactment of the Securitization and Reconstruction of the Financial Assets and Enforcement of Security Interest Act 2002 (SARFACSI) have been implemented. The Act paves the way for setting up ARCs and their empowerment. RBI has issued declared guideline and prudential norms for ARCs. The problem of NPAs management would have acquired entirely different characters for resolutions of NPLs level. The problem of assets reconstruction was a key ingredient of the package along with instituting capital adequacy establishment prudential norms with good supervisory machinery, should be implemented properly sequenced and phased manner which may help the bank to maintain quality of credit portfolio. The proposal for ARF been accepted, the problem of NPAs management would have acquired an entirely different character. The discussion on paper in Finance Minister’s meeting with the Chief Executives of Public Sector and Trade Unions prepared by the Ministry of Finance held out the contrary view that the banks which originated the credit should retain the responsibility for such recovery. Recognizing the recovery of NPAs and, at the same time that “there is no easy solution to the problem of enhancing recovery on existing bad advance or loan”
Dinesh Mittal (2004)\textsuperscript{65} stated that, “When loan is provided to the borrower then some part of it become NPAs. But it is better for the banks that it would be minimized or be reduced as & when possible. In the Indian Financial System, about 2-3 year ago a reduction in the total gross & net NPAs, indicated an improvement in the management of NPAs In the banking world, it is said that NPAs is ‘throwing good money over bad money’ But the SRFAESI provides the formal legal basis & regulatory framework for setting up reconstruction company in India. The article suggests the steps of resolution of NPAs are Credit Information Bureau, Records of Willful Defaulter, D R T, Lokadalats, Enactment of Security Interest Act, Assets Reconstruction Company, Compromise settlement system. These steps have been used for cases of NPAs defaulters for reduction in rate of NPAs. The recommendations as above made the foregoing i implementing a long way in the handlings of NPAs and consequent up-gradation of the asset quality. But there is one better way for the banks and that is, to be very conscious about the rate of NPA that is, it is best for the health of the bank that, ‘Prevention is better than cure’.

Joshi, P.N. (2004)\textsuperscript{66} suggested that “The 90 days norms is irrelevant and impractical in Indian banking because our banking practices are elementary and lending is basically deposit based. In USA a 30 year mortgage loan for housing is almost immediately securitized and the loan goes out of banks and escapes NPA threat. A more fundamental policy deficiency all these year has been the fallacious assumption that

\textsuperscript{65} Dinesh Mittal “(2004) Recovery of NPA” Banking Annunciation “Bank Quest” II B&F VOL 75 /1 April- June 2004 P.P 25 to 28
every farmer is poor and rural India means poor India. Based on such romantic assumptions, an attitude of benevolence permeates the policy prescriptions, which are exploited to the hilt by the few rural rich. Admittedly, a large majority of the villagers are poor and therefore, helpless. In this article says that the recovery performance of rural portfolio. Indian banking system is expected to re-orient its approach to rural lending.

Rural business mostly comprises 74% of the population 41% of middle class and 58% of disposable income. Agriculture is dominating activity in rural sector banking services and mainly provided to the ubiquitous farmer. In the rural area are also governed by the seasonal flow of cash to the farmer. Relaxation has been given to the farmer in the competition of NPA need to be extended to entire rural sectors activities. Farmer is poor, rural India that means poor India means majority of the villagers are poor because of continuous receding water, uncertain rains, over use of fertilizer, erratic power supply etc., consequently they do not improve basically. The co-operative credit institutions rudiment function in the rural sector of the country, facing badly the recovery of their infused capital, required governance and effective professional management. The rural sectors are not developed élan of year and It lacks a sense of direction, NPA of amount is high. Co-operative credit institution particularly at district level should also promote SHGs and NGOs for the credit deployment and improve their overall performance in terms of reducing transaction costs, improving repayment performance and reduction in NPAs.
Ram Mohan, T. T. (2006) stated that the “consolidation is required in the Indian banking system it is among old private sector banks and co-operative banks. It is, these banks that today pose a systemic risk with mergers, at least some of them can emerge as viable regional players and lower the risk to the system”. The article as above shows that how RBI has been working to restructure the private sector banks. New norms have been introduced for private sector banking mainly to expedite the consolation process. The RBI asked the promoters of the banks to bring down their stakes in banks to 10% and provided the infuse capital to make the net worth of their bank to Rs 1000/-crore by 2007. But, the promoters do not raise capital either from the market or through strategic investors by issuing fresh capital. Because old the commercial banks which ever established in sansthan- period (1920). NPA percentage burdened by 3%, and this problem has been faced by small banks whose small paid up capital also reserves. For instance Ganesh Bank has only Rs 1.67 crores in paid up capital and Rs 8.66 crores reserves. Ratnakar Bank and Sangli Bank have very small net worth.

The Tarapore Committee on Capital Account Convertibility (CAC) laid down that 5 per cent level of NPAs in banks is an important milestone to be reached for full convertibility.

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68 Reserve Bank of India, Tarapore Committee, The Report of the Committee on Capital Account Convertibility(Bombay: Reserve Bank of India).
2.3 FOREIGN STUDIES

A study by the Office of the Comptroller of Currency (OCC)\(^69\) of United States in 1988 found that poor asset quality was a major factor responsible for the failure of 98 percent of the banks. Hence, reduction in gross NPAs was desirable.

Chile, Fuentes and Maquieria (2003)\(^70\) analyzed the effect of legal reforms and institutional changes on credit market development and the low level of unpaid debt in the Chilean banking sector. Using time series data on yearly basis (1960-1997), they concluded that both information sharing and deep financial market liberalization were positively related to the credit market development. They also reported less dependence of unpaid loans with respect to the business cycle compared to interest rate of the Chilean economy.

Jimenez and Saurina (2003)\(^71\) analyzed the determinants of the probability of default (PD) of bank loans in terms of variables such as collateral, type of lender and bank-borrower relationship while controlling for the other explanatory variables such as size of loan, size of borrower, maturity structure of loans and currency composition of loans. Their empirical results suggested that collateralized loans had a higher PD, loans granted by savings banks were riskier and a close bank-borrower relationship had a positive effect on the willingness to take more risk. At the same time, size of bank loan

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\(^{70}\) Fuentes, R and Carlos Maquieria (2003) Institutional arrangements, credit market development and loan repayment in Chile, School of Business and Economics, Universidad de Chile

\(^{71}\) Jimenez, G and J.Saurina (2003) 'Collateral, Type of Lender and Relationship Banking as Determinants of Credit Risk Bank of Spain'.
had a negative effect on default while maturity terms of loans, i.e., short-term loans of less than 1-year maturity had a significant positive effect on default.

The study examined the relationship between cyclical lending behavior of banks in Australia argued that the potential for banks to experience substantial losses on their loan portfolios increases towards the peak of the expansionary phase of the cycle. However, towards the top of the cycle, banks appear to be relatively healthy—that is non-performing loans are low and profits are high, reflecting the fact that even the riskiest of borrowers tend to benefit from buoyant economic conditions. While the risk inherent in banks' lending portfolios peaks at the top of the cycle, the risk tends to realized during the contraction phase of the business cycle. At the time, banks' non-performing loans increase, profits decline and substantial losses to capital may become apparent. Eventually, the economy reaches a trough and turns towards a new expansionary phase, as a result the risk of future losses reaches a low point, even though banks may still appear relatively unhealthy at this stage in the cycle.

Lis, et.al., (2002)\textsuperscript{72} concluded that the simultaneous equation model in which they explained bank loan losses in Spain using a host of indicators, which included GDP growth rate, debt-equity ratios of firms, regulation regime, loan growth, bank branch growth rates, bank size (assets over total size), collateral loans, net interest margin, capital asset ratio (CAR) and market power of default companies. They found that GDP growth (contemporaneous, as well as one period lag term), bank size and CAR, had

\textsuperscript{72}Lis, S.F. deJ.M. pages, and J. Saurina (2002), 'Credit Growth, Problem Loans And Credit Risk Provisioning' In Spain, Banco de Espana — Servicio de Estudios, Documento de Trabajo no 0018.
negative effect while loan growth, collateral, net-interest margin, debt-equity, market power, regulation regime and lagged dependent variable had positive effect on problem loans. The effect of branch growth could vary with different lags. The study analyses corporate bond recovery rate adducing to bond default rate, macroeconomic variables such as GDP and growth rate, amount of bonds outstanding, amount of default, return on default bonds, and stock return. It was suggested that default rate, amount of bonds, default bonds, and economic recession had negative effect, while the GDP growth rate, and stock return had positive effect on corporate recovery rate.

Bercoff, Giovanniz and Grimardx (2002) Accelerated failure time (AFT) model in their study of Argentina's banking sector's weakness measured by the ratio of non-performing loans to total loans found that both bank specific indicators such as asset growth, the ratio of net worth to net assets, the ratio of operating cost to assets, exposure to peso loans, and institutional characteristics relating to private bank and foreign bank and macroeconomic variables including credit growth, foreign interest rate, reserve adequacy (import/reserves) and monetary expansion (M2/reserves), besides the tequila effect were reasons behind the banking fragility. Their empirical results suggested that bank size measured by log of assets had a positive effect but asset growth had a negative effect on NPLs. The variables such as operating cost, exposure to peso loans, credit growth, and foreign interest rate had negative effect on NPLs. The macroeconomic

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variables such as money multiplier and reserve adequacy institutional characteristics and tequila effect and positive influence on NPLs.

Fuentes and Maquieira (1998) concluded that the loan losses due to the composition of lending by type of contract, volume of lending, and cost of credit and default rates in the Chilean credit market. Their empirical analysis examined different variables which may affect loan repayment: (a) limitations on the access to credit; (b) macroeconomic stability; (c) collection technology; (d) bankruptcy code; (e) information sharing; (f) the judicial system; (g) pre-screening techniques; and (h) major changes in financial market regulation. They concluded that a satisfactory performance of the Chilean credit market, in terms of loan repayments hinges on a good information sharing system, an advanced collection technology, macro economic performance and major changes in the financial market regulation.

Ottonlenghi, et al. (1993) perceived that arbitration in co-operative societies in Israel was too prolonged and the intervention of the courts in arbitration by the Registrar were the major problems of arbitration.

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74 Fuentes, R and Carlos Maquieira (1998) Determinants of loan repayment in Chile, School of Business and Economics, Universidad de Chile